SUBJECT: **Payment of Developer Fees To OCD Grantees for Development Projects**
Policy Bulletin #29

EFFECTIVE DATE: **June 16, 2003**

The purpose of this policy bulletin is:

1.   To provide OCD Grantees a reasonable developer fee for developing affordable housing while providing an incentive to leverage local project funds. A desired result would be to increase production of affordable units with available MSHDA dollars.

2.   To enable more Michigan local governments and nonprofits, especially CHDOs, to engage in the development of affordable housing.

This Policy will cover the following topics:

- **DEFINITIONS**
- **HOW A DEVELOPER FEE WORKS**
- **PROJECT SOFT COSTS**
- **RATIONALE FOR SETTING DEVELOPER FEE RATES**
- **DEVELOPER FEE LIMITS BASED ON PROJECT TYPE**
- **PROFORMA REQUIREMENTS**
- **DEVELOPER FEE AND MSHDA NET SUBSIDY LIMITS**
- **LIMITS TO DEVELOPER FEE COLLECTED BEFORE PROJECT COMPLETION**
- **PROJECTS CONDUCTED BY A CHDO IN A LOCAL PJ WITH A LOCALLY ESTABLISHED PROCEDURE FOR THE PAYMENT OF DEVELOPER FEES**
- **WHEN PROJECT DEVELOPMENT IS BEING CONTRACTED TO A THIRD PARTY**
- **INCLUDING THE DEVELOPER FEE IN AN APPLICATION FOR A NEW GRANT**
- **INCLUDING THE DEVELOPER FEE IN A GRANT THAT INCLUDES BOTH DEVELOPMENT AND NON-DEVELOPMENT ACTIVITIES**

<u>**DEFINITIONS**</u>

Developer fee: The fee for services paid to a housing developer, based on the Total Development Cost and the scope of the developer=s responsibilities. Developer fees are used by grantees to pay administrative and overhead costs, but are paid as "fees for services rendered" and *do not have to be fully offset by incurred costs.* See definition of "Total Development Cost" for the ways this term is used in the context of various CD housing program models.

Development: In order to be eligible to be paid a developer fee, the grantee must be *developing* property. This means the grantee must either be (a) creating new affordable housing units and marketing them within the local economy, or (b) enabling the improvement of housing within the context of a real estate transaction by arranging financing, etc. Rehabilitating or repairing property under continuous ownership (**such as homeowner or rental rehab**) **is not** housing **development**. MSHDA makes the final determination whether a developer fee is appropriate.

Development Soft Costs: The costs incurred in affordable housing projects described below. Where a developer fee is charged, all soft costs are paid from the developer fee.

NOTE: Closing costs connected with the *sale* of property to eligible low-income homebuyers (real estate commissions and other seller's closing costs) are *not* considered development soft costs for the purpose of this policy. As a result, they are not included in the total project cost and they may be paid from the proceeds of sale rather than being taken from the developer fee.

Total Development Cost: The actual cost of developing the housing unit not including the developer fee. For projects involving *acquisition and resale*, this includes the cost of acquiring the property to be developed, and construction/rehab costs (It does not include any construction contingency costs, or closing costs connected with the sale to the eligible homebuyer.) For projects involving *down payment with rehab*, this includes the initial purchase price (with associated costs) and rehab costs. For *rental development* this includes (as applicable) acquisition costs, construction/rehab, and relocation costs. Computation of the developer fee is based on the total development cost *(excluding* the developer fee).

Total Project Cost: The Total Development Cost plus the developer fee; i.e., total cost of producing the housing unit, including the developer fee.

HOW A DEVELOPER FEE WORKS

A developer fee provides funding to the grantee based on the cost of the project and the scope of the grantee=s responsibilities. It is paid as an alternative to administration, which is paid based on the amount of MSHDA funds used. The developer fee is not based on reimbursing costs incurred, but as a fee for completed units.

PROJECT SOFT COSTS

All soft costs are paid by the grantee from its developer fee. These costs include construction management, program outreach, overhead and administrative costs, including the costs in items (a)-(h) below, whether or not these services are provided by the grantee's staff or contracted to third parties (these costs are similar to those outlined in the HUD HOME rule at 24 CFR part 92.206(d));

   (a)   Architectural, engineering or related professional services required to prepare plans, drawings, specifications, or work write-ups;

   (b)   Costs to process and settle the financing for a project, including construction loan interest;

   (c)   Costs of a project audit that MSHDA may require with respect to the development of the project;

   (d)   Costs to provide information services such as affirmative marketing and fair housing information to prospective homeowners and tenants;

(e)   For rental projects, the costs of funding an initial operating deficit reserve (a reserve to meet any shortfall in income during the project rent-up to pay for operating expenses, scheduled payments to a replacement reserve, and debt service);

(f)   Staff and overhead costs directly related to carrying out the project, such as:

         (1)   Work specifications preparation, inspections, and other services related to assisting owners, tenants, and homebuyers during the project period, or

         (2)   Insurance, property taxes, and utility payments during the project period;

(g)   Costs for the payment of impact fees charged for all projects within a jurisdiction;

(h)   Costs of required environmental review and release of funds that are directly related to the project.

RATIONALE FOR SETTING DEVELOPER FEE RATES

MSHDA establishes developer fees for various program models based on a number of considerations, including, but not limited to:

1.   Reasonable costs for the services provided (MSHDA may adjust developer fees payable on projects at its discretion to assure reasonableness);

2.   The "value" of the development services provided to MSHDA—i.e., the extent to which the project proposed accomplishes MSHDA's priorities for investment (e.g., revitalization of a distressed target area of importance to the community, the promotion of income diversity in communities, creation of a healthy balance of owner occupancy and affordable rentals in a target area, etc.);

3.   The extent to which payment of a developer fee promotes the use of leveraged financing, or helps to offset the staff costs of grantees seeking to produce more units while using fewer MSHDA dollars.

DEVELOPER FEE LIMITS BASED ON PROJECT TYPE

Examples, as they apply to typical MSHDA CD program models, are shown in the table below. Grantees proposing other kinds of projects may propose a percentage rate to be applied, based on the development functions for which they will be responsible:

- Acquisition/Development/Resale with new construction or substantial rehabilitation (rehab exceeding $25,000): 15% of total project cost

- Acquisition/Development/Resale with moderate rehabilitation (rehab of $25,000 or less): 10% of project cost

- Homebuyer Purchase/Rehab: 8% of total project cost

- Rental Development with new construction or substantial rehab: 15% of total project cost

- Rental Development with moderate rehab: 10% of total project cost

These percentages apply to CD's various program models; for example, the applicable percentage will not normally vary project-by-project. However, **MSHDA reserves the right to adjust (i.e., reduce) the developer fee to be paid whenever the scope of the responsibilities of the grantee as a developer is substantially reduced.** MSHDA may do this either for a whole grant or on a project-by-project basis within a grant. MSHDA will inform the grantee of this adjustment prior to project set-up.

PROFORMA REQUIREMENTS

If a developer fee is charged, a detailed pro forma must be submitted for each project, showing developer fee and total soft costs, total development costs, and all sources of financing used to meet these costs.

DEVELOPER FEE AND MSHDA NET SUBSIDY LIMITS

The estimated developer fee is included as a part of the rehab or new construction activity and is included in the project set-up. **Developer fees are not included when calculating the "net subsidy limits"** allowed under OCD's program parameters.

EXAMPLE: An ADR project is proposed involving $15,000 acquisition and $40,000 rehab. The total development cost before the developer fee would be $55,000. The developer fee payable would be $8,250 (15% of $55,000). Total Project Cost would be $63,250. If the grantee were to leverage, say, $45,000 in project costs locally, the project would be set up for $18,250, and the fee would be unaffected

LIMITS TO DEVELOPER FEE COLLECTED BEFORE PROJECT COMPLETION

For good cause, up to 50% of the fee may be charged to the project prior to completion, with the approval of your CD Specialist.

PROJECT CONDUCTED BY A CHDO IN A LOCAL PJ WITH A LOCALLY ESTABLISHED PROCEDURE FOR THE PAYMENT OF DEVELOPER FEES

Upon review of the local PJ policy, MSHDA may at its discretion and with the consent of the PJ and HUD, elect to award its funds to the PJ to be administered under its local policies (the local PJ will be responsible for awarding funds and assuring compliance), or

MSHDA may elect to implement the project using either developer fees or administrative fees. The grantee will be responsible for documenting that MSHDA and the PJ are not both paying for the same services. Generally, where a developer fee is being charged, MSHDA funds and local PJ funds should not be used on the same project.

WHEN PROJECT DEVELOPMENT IS BEING CONTRACTED TO A THIRD PARTY

1.   The grantee will need to show that the services of the developer have been procured in a fair and open manner. The above figures are maximums allowed by MSHDA, but the cost of development services should be considered when securing a developer.

2.   Site monitoring will examine:

a. Whether development services are being provided by the lowest-cost responsible party; and

b. Whether the services specified in the contract are being satisfactorily delivered for the contracted price.

INCLUDING THE DEVELOPER FEE IN AN APPLICATION FOR A NEW GRANT

Developer fees are not applied for separately. They are included in the pro forma used to apply for fund and are included in the project costs. The developer fee is not a separate line item; include it in the construction/rehab line of the application budget.

INCLUDING THE DEVELOPER FEE IN A GRANT THAT INCLUDES BOTH DEVELOPMENT AND NON-DEVELOPMENT ACTIVITIES

Contact your CD Specialist prior to proceeding. Generally, admin reimbursement will apply to the non-development components (components other than homebuyer or rental development).

.